DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

PROPERTY OPERATIONS POLICY

BOARD APPROVAL DATE: 11 DECEMBER 2001

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ABBREVIATIONS

Advanced Countries	Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia
Early/Intermediate Countries	Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Romania, Tajikistan, Turkmenistan, Ukraine and Uzbekistan
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
Sector	Property
sqm	square metres

EXECUTIVE SUMMARY

At the end of 2000, the Bank's cumulative commitments to the Property Sector in the Bank's countries of operation totalled Euro 450 million, supporting investments of Euro 1.5bn. Through its activities in these sectors, the Bank contributes to the development of markets which form part of the basic business infrastructure expected by foreign investors as a prerequisite to their investment in a particular country and for the sustained expansion of their business overtime. Further, the Bank's engagement in policy dialogue especially with regard to property rights and mortgages contributes to the advancement of the institutional framework that is a prerequisite to a proper development of the property markets. Additionally, through its investments and the backwards and forward linkages they create to related economic sectors, the Bank also helps in the development of the local construction markets and relevant property and tourism service sectors thus contributing to the shift of local economies from industry to services over time. The success of the Bank's involvement in the development of local real estate markets is likely to be more pronounced in the next few years in the Advanced Countries in particular where diversity of activities and instruments will be the focus. In these countries, significant developments have already taken place in capital cities, many with the Bank playing a leading role as a catalyst for cofinancing. For the real estate markets in these countries to develop further and the developers and financiers to be incentivised to move into the provinces (and to Early/Intermediate countries as well as Russia), the entirety of the property markets in the Advanced Countries need to function properly. The Bank therefore has a leading role to play in developing the depth of the secondary property markets in the Advanced Countries mainly through the introduction of new instruments which will target both domestic and international investors. Finally, in the regional centres the Bank has a key role to play as a risk taker in the development of the primary property and hotel markets by being a catalyst for the development of institutional quality real estate of local proportions. By being flexible and innovative the Bank is in a position to promote transition effectively in the property and hotel markets of its Countries of Operation and in parallel remain highly additional by introducing new types of investors, both local and domestic, which contribute to the increase in scope of financial sources available for the development of the sector and thus promoting transition further.

In the financing of operations in these sectors the Bank has the following objectives:

1. Promoting private sector investment through equity and debt financing and creating long term investment vehicles and new products for local and foreign investors in order to promote both the primary hotel and property markets as well as the secondary markets.
2. Participating in smaller projects through direct sector specific investment funds and credit lines aimed at supporting SMEs.
3. Supporting projects that transfer technology, knowledge and management skills to the property and tourism markets.
4. Developing the local construction and building materials sectors.
5. Supporting environmentally sustainable development projects including projects that support urban regeneration.

The implementation of these objectives will depend on the transition stage of a particular country. The legacy left by communist countries was one of state or cooperative ownership of property facilities and typically low standards of service and maintenance. Property development and pricing bore little relation to economic opportunity costs. There was a lack of international standard hotels and office space, housing was highly subsidised and supply driven, warehouses were inadequate for proper storage and development. In property, transition must be seen as a process in which different elements of the business environment progress jointly and reinforce each other, primarily as a function of business volume. In a simplified manner one could depict the transition process as typically starting with the creation of hotels and office space in capital cities, then extending to include warehousing and logistics and finally moving to retail, mixed use, leisure and residential and also to regional centres as GDP levels rise.

In response to progress in economic transition and the impact (very reduced FDI) of the Russian crisis of 1998 on the property markets of Russia and the region, commitments and pipeline development have recently focused on the Advanced Countries. At the end of 1998 44% of the Bank's portfolio in the Sector was in Advanced Countries and 16% in Russia compared to the end of 2000 when the relevant figures are 54% and 9%. The product split has also changed dramatically; at the end of 1998 the Bank's portfolio in the Sector had 10% of equity in commitments compared to 47% at the end of 2000.

For the medium term the target is to rebalance the geographical distribution of commitments away from the Advanced Countries while continuing to address the transition needs and market demand for EBRD's presence in those markets.

The Bank has been highly additional in the Sector as can be seen from its mobilisation ratio of 3:1. Commercial banks, in particular, are either not able to extend term loans in some of the Bank's countries of operations or are limited in the tenor they can provide without the Bank's involvement. Property investments due to their capital intensive nature and the return requirements of developers and financial investors require long term debt financing in order to be successful.

Since 1995, the time of the last strategy paper for the Property Sector, the Bank has played a catalytic role in supporting the development of the Sector by providing mainly project financing in the form of secured senior debt financing to local/foreign joint ventures. The main sectors financed over this period have been city centre hotels, offices and warehousing in response to the transition needs of the economies where little commercial property infrastructure existed in the early 1990s of a standard acceptable to foreign investors. Since that time, however, there have been significant developments in the property markets in the Bank's countries of operation. The degree of change has varied from country to country and has been a function mainly of the level of foreign direct investment, the improvement of GDP per capita and the influx of world class developers. This changing environment necessitates more flexibility and imagination on the part of the Bank to develop appropriate products to meet the increased demand in primary markets as well as to support the development of secondary property markets which will increase market depth.

In response to market changes, equity products are likely to be more appropriate in the Advanced Countries as well as debt with longer maturities. In Russia and the Early Intermediate countries focus will remain on senior loans; equity may be considered only in selective cases where the risk/return considerations justify it. In terms of sub-sectors the Bank will continue working on developing office and hotel infrastructure in capital and major regional cities and warehousing in the Early/Intermediate countries and Russia as well as in the regional centres of the Advanced Countries. In addition to the sub sectors financed to date, the Bank will develop its activities in residential, retail/mixed use and leisure tourism depending on the transition demands of the Bank's countries of operation. In parallel with implementing projects according to the priorities stated above, the Bank will continue a policy dialogue on institutional reform which is a necessity for well functioning property markets.

The policy proposes a flexible approach to financing the Property sector depending on the transition stage of the relevant countries and the Bank's ability to be a catalyst in moving the transition of the property markets further.

1. PROPERTY IN THE COUNTRIES OF OPERATIONS

1.1 SECTOR DEFINITION

- The Bank's definition of the Property Sector encompasses the majority of Real Estate and Accommodation standard industrial classification codes. The primary Property sub-sectors are office, retail, mixed-use, warehousing,residential and hotels. The hotel sector can be subdivided into city centre hotels, regional city hotels and resort hotels. Please see Annex A for a comprehensive list of the sub-sectors.

- The role of the Bank in the Sector is to serve as a catalyst for economic transition and growth by financing new developments that provide the expected business infrastructure for foreign investment in all of its countries of operation and to support the evolution of secondary property markets in countries at more advanced stages of transition both through setting examples with its selection of projects and through policy dialogue on institutional reform.

1.2 RECENT MARKET DEVELOPMENTS

- Since April 1995, the date of the last strategy paper for the Property Sector, there have been significant market developments in the property markets in the Bank's countries of operations. The degree of change has varied from country to country and has been a function of three main factors:

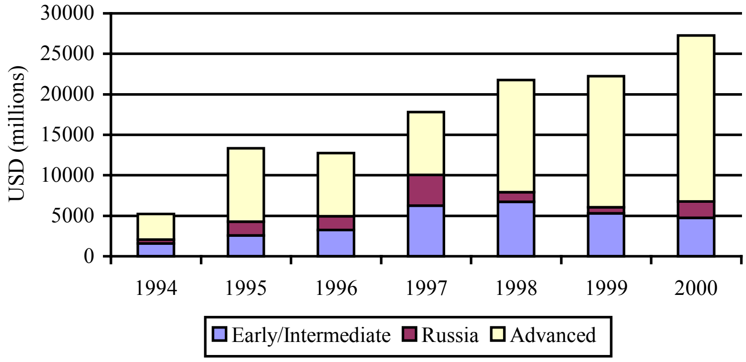
  - FDI growth has been heterogeneous across the region but the general trend is that of increasing investment, as highlighted in Chart 1.2.a. FDI in the Bank's countries of operations has grown from approximately USD 5 billion in 1994 to nearly USD 27 billion in 2000.

  - Average GDP per capita for each of the Bank's three transition categories has grown strongly every year up to 1999. The exception is Russia in 1998 and 1999. The Russian crisis also affected growth in the region overall and in particular the Early/Intermediate countries, as highlighted in Chart 1.2.b.

  - Increased activity by well-capitalised and experienced developers in the region has been an important driver in the local property markets. Construction output growth in the Central Eastern Europe Region (Czech Republic, Hungary, Poland and Slovak Republic) has outpaced Western Europe in 3 of the last 4 years and is expected to do so again in 2000, as highlighted in Chart 1.2.c.

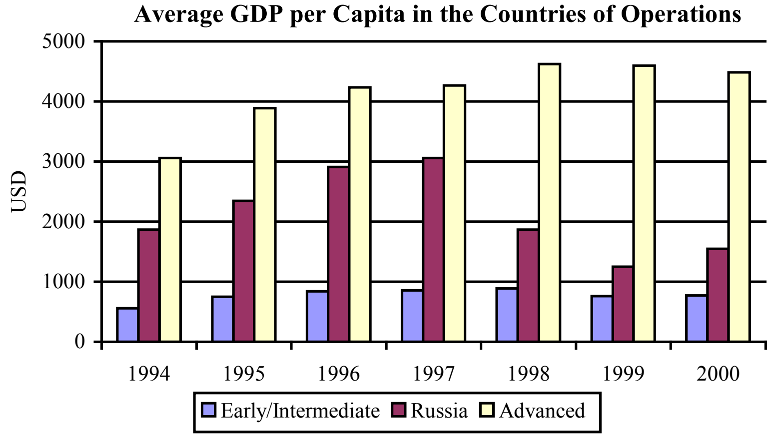
- Although the general trend in the Bank's countries of operation has been toward continued growth in the sector, there have been a number of short-term setbacks in specific markets. Russia represents the most notable example, where the economic crisis of 1998 served to dampen development activity in most of the region. The Balkans represent another example, attributable both to external factors such as the conflicts in Bosnia and Kosovo, and internal factors such as a lack of commitment to strategic investor privatisation.

Chart 1.2.a.
Foreign Direct Investment in the Countries of Operations



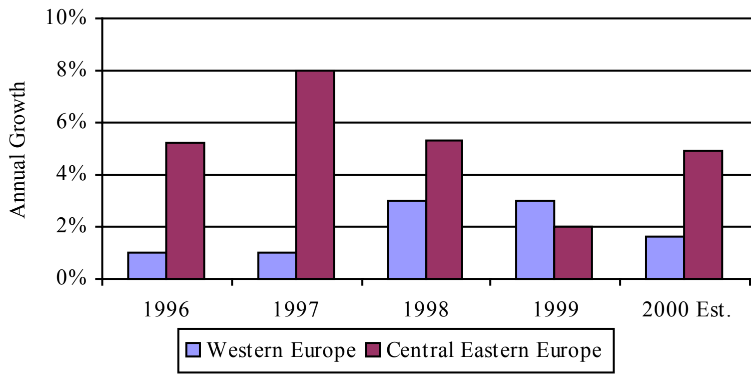
Source: EBRD 2000 Transition Report.

Chart 1.2.b.
Average GDP per Capita in the Countries of Operations



Source: EBRD 2000 Transition Report.

Chart 1.2.c.
Construction Output Growth

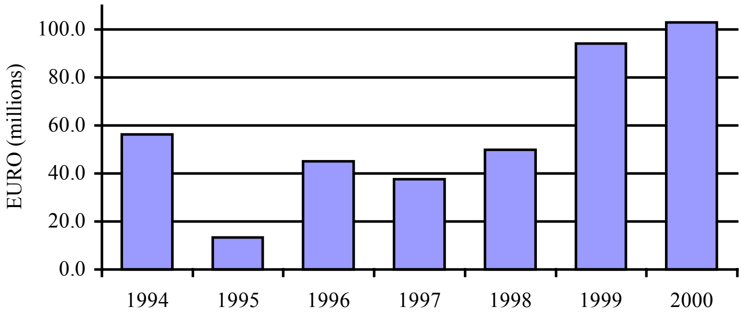


Source: EUROCONSTRUCT. Central Eastern Europe includes Czech Republic, Hungary, Poland and Slovak Republic.

1.3 EBRD INVOLVEMENT IN THE SECTOR TO DATE

- As of 31 December 2000, the Bank had committed to 32 Property projects totalling EURO 450 million in its countries of operations. Annual signings have increased from EURO 56 million in 1994 to EURO 103 million in 2000, representing growth of 80% over the period. Annual commitment growth is summarised in Chart 1.3.a.

Chart 1.3.a.
Property and Tourism Annual Commitments



- The majority of signed Property projects are focused in the office, mixed-use and hotel sub-sectors. Aggregate commitments by project type and by transition stage are summarised in Charts 1.3.b. and 1.3.c. Please refer to Annex B for a comprehensive list of projects.

Chart 1.3.b.
P&T Commitments by Project Type

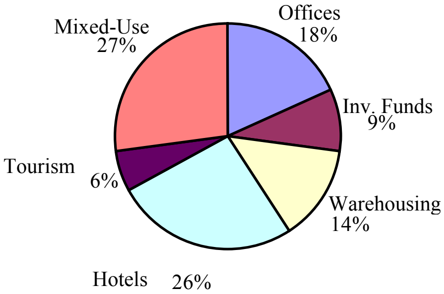
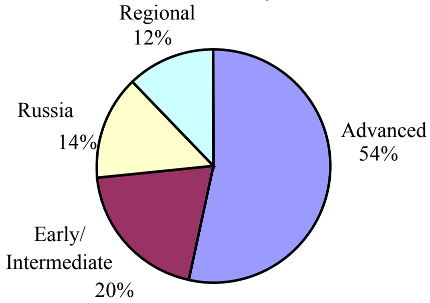


Chart 1.3.c.
P&T Commitments by Transition



- To date, the Bank has played a catalytic role in supporting the development of the Sector by focusing on project financing in the form of secured senior debt to local/foreign joint ventures. Mezzanine products and equity (often with put/call provisions) have been provided as a means to introduce a financial upside alongside a senior debt position.

- The Bank's response to the changing transition needs was most marked in 1999 and continued in 2000. Focus was given to developing equity or quasi-equity investments primarily targeting the EU accession countries. Also in terms of sub-sectors, in the Advanced Countries more emphasis was give to retail and mixed use developments reflecting the changing needs of the markets.

- In response to growing demand, the Bank also participated in the establishment of two Sector-specific equity investment funds in the Advanced Countries (Pioneer Polish Property Fund (BDS97-158) and Central Europe Property Partners Fund (BDS00-68)).

- The Bank has been active in all Property sub-sectors other than residential development. The lack of activity in residential development is largely attributable to insufficiently enforceable mortgage laws, lack of relative currency stability and inadequate local long-term debt markets.

- The Bank's involvement in the Tourism sub-sectors has been focused almost exclusively on city centre hotels. Regional city hotel development in the market has been limited but will gain in importance as business activity spreads to regional centres. Opportunities for leisure tourism in the Bank's countries of operations are only now being developed and only on a very selective basis, reflecting a lack of strong sponsors, the cyclical nature of the sector and relatively low levels of disposable income in the Bank's countries of operation.

1.4 PROJECT EVALUATION AND LESSONS LEARNED

1.4.1 EBRD

- The Bank's evaluation of signed and disbursed projects has produced a number of lessons learned that are applicable to future financing in the Sector. A total of nine operations have been post evaluated by the Project Evaluation Department in the Sector. Several lessons have arisen in more than one project and are now addressed in the appraisal of all Sector project proposals.

  - Future transition impact potential and additionality can be closely linked to new instruments and participants. Links to domestic financial markets and to secondary property market development can be gradually developed in collaboration with existing domestic banks and other financiers.

  - Lender's supervisors should be appointed for all construction and Property projects, both to oversee construction work, review the initial budget presented by the sponsor and advise on implementation issues.

  - It is important to ensure that the project guarantor in construction projects is strong and sufficiently solvent to support a completion guarantee.

- It is essential that adequate contractual arrangements are agreed to enable the Bank to control conflicts of interest, in particular when contractors are shareholders also.

- Contracting can aim to apply stringent controls during implementation while being less administratively demanding thereafter.

- Carrying out high quality management activities reduces the roll-over lease risk and secures interest of first class tenants.

- The Bank could consider grant TC funding to cover legal due diligence costs for pioneering projects.

1.4.2 IFC

In addition to learning from its own experience, the Bank can gain insight from lessons learned at IFC. These lessons can be particularly helpful in the Tourism Sector where IFC has participated in a number of projects around the world. It should be noted that IFC does not have a dedicated sector team for tourism.

- Local involvement is critical to the success of a resort hotel project.

- Given the inherent cyclicality of the sector, financial plans should be conservative.

- Tour operators are reluctant to book clients into a new resort hotel until after it has opened and demonstrated smooth operation.

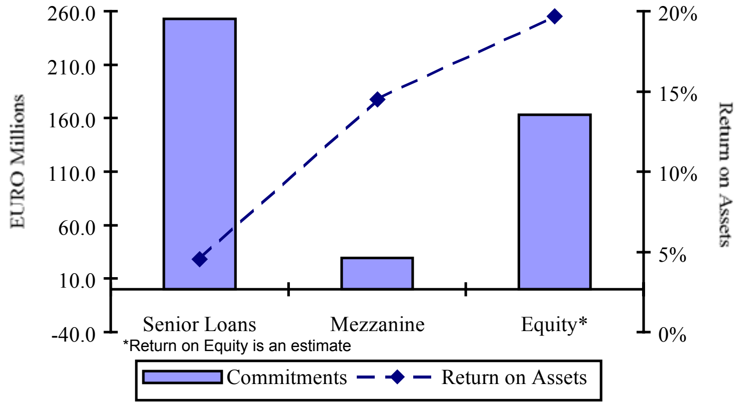
- A resort hotel with facilities superior to those of its competitors may not necessarily achieve higher room rates but may achieve higher occupancy.

- Upgrading a hotel will not necessarily result in a commensurate increase in real room rates. Many tour operators view refurbishment and maintenance as a requirement to continue promoting and booking hotels.

1.5 PROFITABILITY OF THE SECTOR FOR EBRD

- The Bank's commitments and estimated annual return on assets for Senior Loans, Mezzanine Products and Equity in the Sector at 31 December 2000 are provided in Chart 1.5.a.

Chart 1.5.a.
Property and Tourism Profitability at 31December 2000



- Property is among the Bank's most profitable sectors in senior lending. Based on the existing portfolio, the expected gross annual return for senior lending is approximately 4.25% to 4.50% over Libor. A typical senior loan tenor for the Bank in the Sector is 10 years, although extending maturities even further in accordance with international real estate norms is one of the Bank's transition objectives for the future.

- The existing portfolio of mezzanine products produces an estimated annual return on assets of approximately 14.5% to 15.0%. The Bank's mezzanine products have included subordinated debt and portage equity involving pre-agreed exit prices with sponsors.

- Internal rates of return for the Bank's equity investments in the Sector are expected to be in the region of 19.0% to 20.0%. The Bank made a number of equity investments in the Advanced Countries in 1999 with exit horizons between 2003 and 2005.

- Average risk rating of the property portfolio is 5.5.

2. STATE OF THE SECTOR: TRANSITION CHALLENGES

2.1 SECTOR OVERVIEW

Background

- Communist economies were characterised by state or cooperative ownership of property facilities, and typically low standards of service and maintenance. As in other sectors, property development and pricing bore little relation to economic opportunity costs. There was a lack of international standard hotels and office space, housing was highly subsidised and supply driven, warehouses were inadequate for proper storage and development.

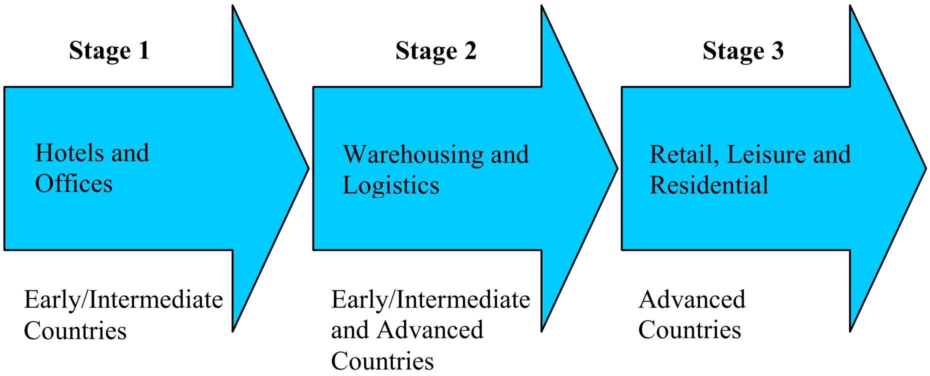
- Sector transition requires the following steps (though not necessarily in sequence):

- Liberalisation of private sector entry and creation of competition in commercial and residential property development, including through privatisation and providing a broad measure of discretion to set prices and rents.
- Development of the legal and administrative framework for private property ownership and development (legal basis for private property rights over real estate, property registries, cadastral maps, collateral legislation and enforcement). Simplification of administrative requirements e.g. in the context of planning permissions, and other steps limiting the scope for corruption.
- Introducing and/or strengthening corporate governance in property development companies including addressing issues of conflict of interest that may be present in certain ventures.
- Ensuring that appropriate environmental and health and safety standards are adhered to.
- Improved warehouse logistics, office space and business hospitality facilities in order to reduce transaction costs and attract international business. Introduction of mixed use developments in order to reduce the fragmentation of the retail sector and leisure industry.
- Provision of adequate retail and business premises in general. Most enterprise surveys run in the region find that for local private enterprises of small and medium sized scale a big impediment to doing business and to expansion is the inability to access adequate premises. In some areas this impediment is even more serious than lack of finance for the existence of the enterprises.
- Substantial reduction in distortionary subsidies in the residential housing market and moves towards a more targeted system of support.
- Introduction of legislation to allow for mortgage lending. This by itself will not trigger such activity by commercial banks, as other pre-requisites such as a reasonably high level of disposable income, are necessary. A well functioning mortgage lending market will spur activity in the residential property market. This will have a direct and positive effect on labour mobility, which is still lacking even in the most advanced transition countries. Ultimately it will support levelling out of economic inequalities within the region.
- Creation of secondary markets in property in order to increase liquidity and provide the incentive of successful exits for investors who are then more likely to reinvest funds in other projects. In this way, functioning secondary markets encourage growth in the primary markets. A mature secondary market would ultimately lead to the acceptance of local property as an asset class and to the entrance of non-specialist investors seeking to diversify portfolios, such as insurance companies and pension funds, as has happened in the mature property markets in the rest of the world.

Stages of Transition

- Transition in the Sector must be seen as a process in which different elements of the business environment progress jointly and reinforce each other, primarily as a function of business volume. One can use the following simplified framework of a three-stage analysis to depict the stages of transition. Although the stages are to some extent sequential, there is significant overlap and each stage requires sustained long-term support from the Bank to achieve full maturity.

The first challenge for the Bank is to support the evolution of the Sector markets in the capital cities of the region. A second challenge will be to extend that success to the regional centres.



- Stage 1 is characterised by a market environment with supply/demand imbalance and slow progress in Property development. The first Sector developments to appear in such an environment tend to be international-standard hotels and office accommodation. These facilities help to attract foreign investment and develop local businesses during the early stages of transition. Business traveller demand can help to support tourism as it provides a regular customer base for hotels that can serve both the business and leisure tourist segments of the traveller market.

- Stage 2 is characterised by a market that has already attracted meaningful business activity and has developed a sustained demand for consumer goods. As this demand rises, there is an increasing desire on the part of producers and traders to outsource their logistics function. The introduction of international-standard warehousing and logistics facilities follows in response to demand. These new facilities produce an economic benefit by reducing holding costs and allowing greater pricing flexibility. Ultimately, trading by foreign companies can stimulate the local production of goods.

- Stage 3 is characterised by a stabilising economy with growing purchasing power and increasing disposable income. Retail and leisure developments are suited to this environment and local production and distribution of goods is further strengthened. Large mixed-use development can also produce a more efficient trading environment than previously fragmented retail networks. A flourishing retail and leisure segment signals the development of a self-sustaining local economy. As incomes rise, and subject to sufficient legal infrastructure and relative currency stability, residential development can follow. It is at this stage that urban development and regeneration issues acquire more importance including use of brownfield sites. On the one hand the developments are of a large enough scale to be able to play a role in urban regeneration as well as to attract the attention of the municipalities which are a key component for the successful implementation of such projects.

General Sector Challenges

- The key Sector challenges currently faced in the Advanced Countries are generally focused on institution building and the deepening of markets to provide greater liquidity. Early/Intermediate Country and regional centre challenges are focused primarily on privatisation and restructuring.

- To date, the evolution of the property markets in the Bank's countries of operations has been primarily a capital city phenomenon. Warsaw, Budapest and Prague are the most advanced in their development, with Warsaw representing the model of Property transition thus far. Behind these market leaders lie Moscow and a number of Advanced Country capitals. There has been little activity in the regional centres of the Advanced Countries and in the nascent markets of the Early/Intermediate Countries. Extending Sector development to these markets will be an important milestone in transition.

- Among the most important challenges in the Advanced Countries is the development of secondary property markets. Secondary markets encourage growth in the primary markets as investors and developers are given greater confidence regarding exit potential. The proper functioning of secondary markets is currently impaired by a lack of liquidity and by a scarcity of vehicles capable of providing depth, such as large property companies or equity funds. A mature secondary market will ultimately lead to the acceptance of local property as an asset class and to the entrance of non-specialist investors seeking to diversify portfolios, such as insurance companies and pension funds. The Bank's assistance in this area will also encourage the developers and primary investors to move further east to the Early and Intermediate Countries. Finally, a liquid secondary market for commercial property induces the development of a secondary market for private property, which is essential for building wealth over time.

- Urban regeneration issues are likely to become an important challenge in the Advanced Countries in particular, as more and larger scale developments take place. In Early/Intermediate Countries urban regeneration issues will be taken into account in individual projects as appropriate. Such issues will be dealt with in cooperation with the municipalities and depend to a large extent on the relevant municipalities priorities and goals in urban planning.

- An important factor that continues to constrain growth in the property sector throughout the region, to a greater or lesser extent, is that of property titles and lack of sufficient institutional reform both of which are prerequisites for market entry. Obtaining clear titles to the land and buildings is still an issue in all countries of operation although in the most advanced it is an issue that has been recognised and is being dealt with by the local and central governments. The Bank's contribution through careful project selection resulting in strong demonstration effect in these areas is critical.

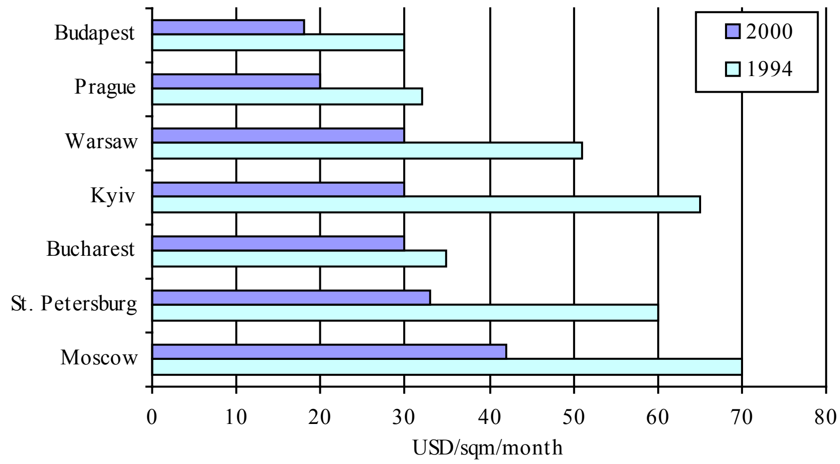
2.2 PROPERTY

2.2.1 Office

- The office markets in the Bank's countries of operation continue to be generally supply-constrained. Frustrated demand for international standard accommodation has resulted in rents above levels that are justified by economic fundamentals. Chart 2.2.1.a. highlights average 1994 and 2000 prime office rents for the largest office markets in the Bank's countries of operations.

- Although the region has seen a broad reduction in rents over the period, the sources of this reduction differ by country. Development to satisfy demand has been the prime force behind rent declines in the advanced markets of Warsaw, Budapest, and Prague. Declines in Moscow, St. Petersburg and Kyiv cannot be exclusively attributed to this cause, for an important source of rent reduction in these markets was a short-term decline in demand from international tenants following the Russian financial crisis of 1998.

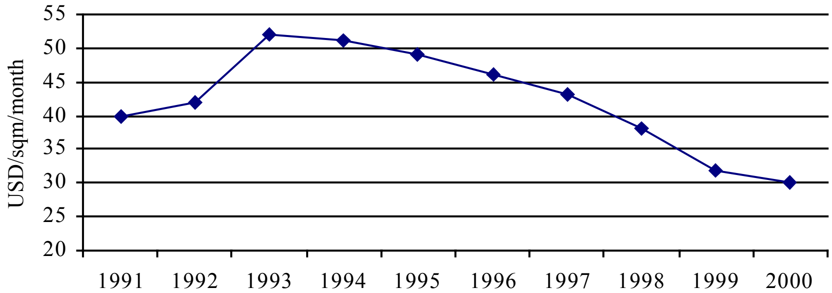
Chart 2.2.1.a.
Prime Office Rents



1994 Sources: Jones Lang Wootton, Economist Intelligence Unit.
2000 Sources: Colliers.

- Office sector transition is best exemplified by the Bank's experience in Warsaw. In the early years of the Bank's operation, the Warsaw market for office space suffered from acute under-capacity and rents exceeded USD 50 sqm/month. Over the next 5-7 years, developers attracted by high returns entered the market and produced an unprecedented increase in capacity. Among the successful developments in Warsaw during this period were the Atrium Business Centre (BDS94-42), Waresco (BDS95-167) Sp. z o.o. and the Warsaw Financial Centre (BDS96-28). Currently, the market is settling into supply/demand equilibrium with office rents in the region of USD 30 sqm/month for prime space, as shown in Chart 2.2.1.b. In many ways, Warsaw has matured as a property market and is beginning to see the birth of a secondary market for existing properties.

Chart 2.2.1.b.
Warsaw Average Class A Office Rents



Source: DTZ, Coulderq & Kubas, EIU, Colliers.

- Office markets in the Early/Intermediate capital cities can be compared with Warsaw 10 years ago. Under-supply of space, more acute for Class A international space, is commonplace in these capital cities. Rents are generally in decline as supply slowly chases demand, but substantial development of international space, such as the 11,000 sqm World Trade Centre completed in Bucharest in 1994, is still sporadic.

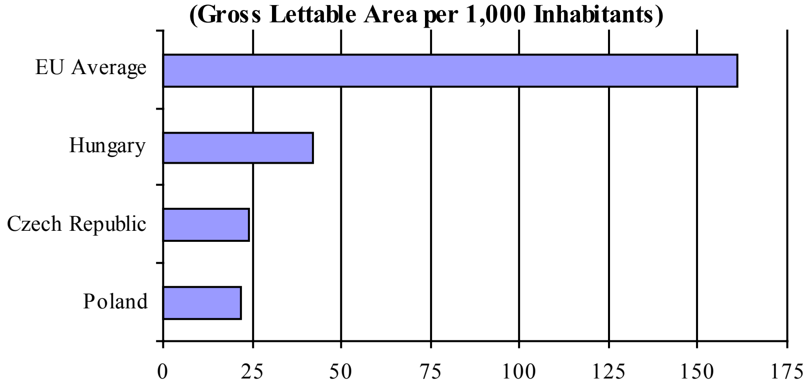
- Factors constraining the development of suitable office space in the region include a scarcity of investment capital, vague and inconsistent planning regulations and a lack of local expertise in construction management and operation. Addressing these challenges by supporting projects with positive demonstration effects will be critical in encouraging growth.

- Office space supply in the Bank's countries of operations will have an important secondary effect on the development of the local economies through its ability to stimulate economic activity. Enterprise surveys performed by the Bank in Bulgaria, Russia and Albania note that a lack of access to appropriate business accommodation is as large a constraint to foreign investment as financial and taxation concerns.

2.2.2 Retail

- Rising levels of disposable income in the Bank's countries of operations have driven demand for efficient retail space from both local and foreign retailers. Globalisation and consolidation in the retail sector world-wide has encouraged successful domestic retailers to pursue new markets in Central Europe as their home markets become saturated. Retailers in this category include Ahold (Netherlands), Migros (Turkey) Metro (Germany), Carrefour and Casino (France), and Tesco (UK). The growth potential of countries such as Poland, Hungary, the Czech Republic and the Slovak Republic continues to attract interest from these leading retailers. The international comparison of retail space per inhabitant in Chart 2.2.2.a. highlights that even the Advanced Countries remain behind European averages.

Chart 2.2.2.a.
1999 European Shopping Centre Density
(Gross Lettable Area per 1,000 Inhabitants)

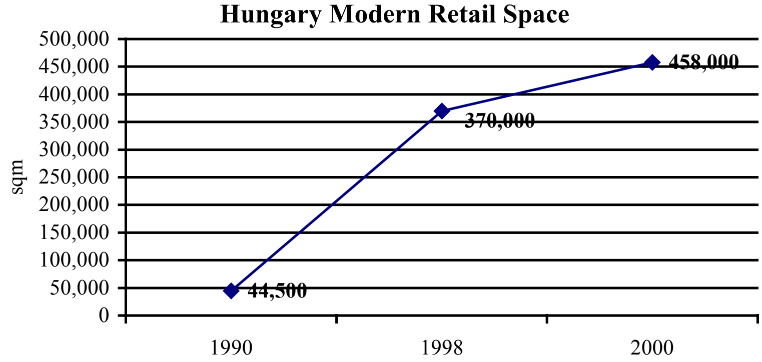


Source: Healy and Baker.

- Tenant commitment and quality remains an important consideration in retail development in the Bank's countries of operations. The early commitment of commercially successful and creditworthy anchor tenants is critical to the success of any large-scale retail development. Local tenants must be convinced that it is appropriate to accept the terms of tenant leases that protect the landlord and its lending bank. Other important considerations in successful retail development include catchment area size and strong management.

- Budapest represents the best example of retail transition in the recent past. The dramatic changes experienced in the Budapest retail landscape can be attributed in part to the active involvement of TrizecHahn Corporation, a leading retail developer and shopping mall operator based in Canada. The 45,000 sqm Polus Centre and 47,000 sqm West End City Centre have set the standard for Western-style retail development in the region. The TrizecHahn properties, together with those of other major developers, have significantly increased the amount of modern retail space, as shown in Chart 2.2.2.b.

Chart 2.2.2.b.
Hungary Modern Retail Space



Source: The Economist Intelligence Unit Ltd.

- Through its co-investment facility with the AIG New Europe Fund (BDS98-63), the Bank is an equity partner in the TriGranit joint venture developing the TrizecHahn properties. Building on the success of the retail developments in Budapest, the Bank has become involved with TrizecHahn as a lender to the Bratislava Polus Centre (BDS99-62) in an effort to expand retail development further into the Bank's countries of operations.

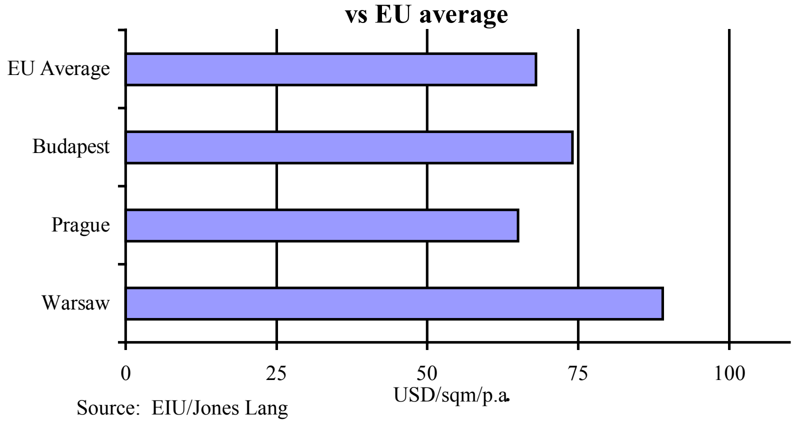
- The retail network fragmentation that was present in Budapest several years ago can be seen today in many of the Early/Intermediate Countries. As general economic conditions improve in the long-term, these markets can be expected to follow in the footsteps of Budapest, Warsaw and Prague and to consolidate their retail offerings. Retail evolution from simple supermarkets to state of the art shopping malls will necessarily be dependent upon an influx of experienced developers into these markets.

- Major constraining factors in the development of the retail sector include the ambiguity of site and building ownership and the excessive bureaucracy often encountered with local permitting procedures. The evolution of retail markets will likely see permitting procedures streamlined, but planning restrictions may also increase as in Western Europe and the U.S. where environmental concerns have been raised. Additional constraining factors continue to be disposable income levels, low margins in retailing, poor road systems and distribution networks and poor public transport facilities.

2.2.3 Warehousing

- The development of warehousing and logistics facilities tends to track general economic conditions even closer than other property sub-sectors due to its links to the consumer product sector. Most of the warehousing stock in the Bank's countries of operations is antiquated and inadequate for proper storage and logistics management. Tenants increasingly demand secure facilities with generous ceiling heights, wide column spacing and modern loading facilities. These traits are common in Western European markets but are only now beginning to appear in any meaningful way in the Bank's countries of operations, most notably in Poland (Warsaw Distribution Centre (BDS95-22) and SEEV Sp. z o.o. (BDS95-139)), Czech Republic and Hungary. Chart 2.2.3.a. highlights the average cost of storage in EU capitals and the corresponding cost in Central European capitals in 1999. The high cost of storage is still an issue that affects the cost of businesses operating in CEE. Greater availability of appropriate warehousing space should lead to greater competition and a reduction in the cost.

Chart 2.2.3.a.
1999 Industrial Warehousing Rents in Central Europe vs EU average

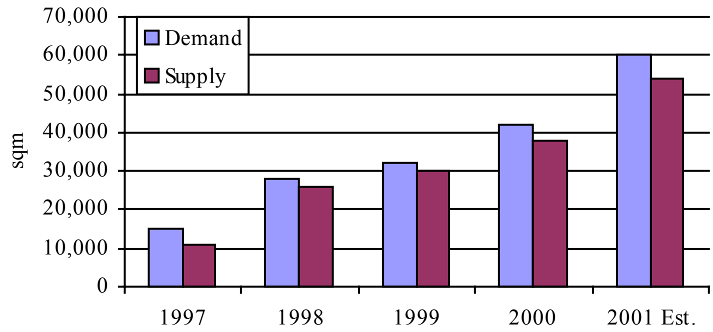


Source: EIU/Jones Lang

- The warehousing sub-sector has seen early signs of international development in the Early/Intermediate transition countries, as well. Russia, for example, continues to have a need for modern logistics facilities and the Bank has already participated in one such development, Faure et Machet Russia (BDS97-155). Developer interest has also been expressed in Romania (Italian-Romanian Industrial Development Enterprise (BDS98-115)), which shares the typical warehousing profile of high capacity but inadequate standards.

- The modern warehousing market in Bucharest is indicative of those found in the more advanced of the Early/Intermediate Countries. Demand outpaces supply and is expected to continue to do so over the next few years. Companies are just now beginning to consider employing service professionals specialising in logistics and transport, and as this trend progresses even more modern warehouse space will be needed. Chart 2.2.3.b. highlights the supply and demand trend for the Bucharest modern warehousing market.

Chart 2.2.3.b.
Bucharest Modern Warehousing Annual Supply and Demand



Source: Colliers.

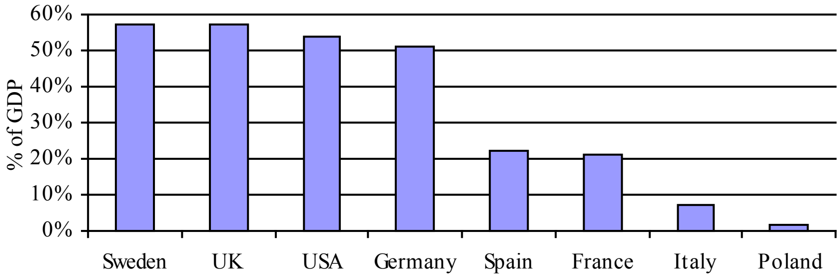
- The transition challenge in warehouse development remains to provide facilities of standards appropriate to growing economies. In the Early/Intermediate Countries and in Russia, the challenge is to accommodate growing demand for consumer products with increased capacity. Although many of the Advanced Countries already possess warehouse infrastructure, there remains a need to improve standards in line with demand in these countries. The issue is most acute in the accession countries, as compliance with EC Directive 92/12/EEC regarding general arrangements for products subject to excise duty would require the construction of "tax warehouses". The needs of logistics service providers in operating such facilities would require significant investment in infrastructure, such as the provision of rail links to the site.

- The evolution of local retailing also contributes to growth in warehouse demand and development. There remains significant potential for supply-chain cost reduction in the Bank's countries of operations and manufacturers and retailers are likely to increase collaboration to find optimal methods of delivery and storage. Such methods may ultimately lead to the centralisation of distribution to a retail hub from which retailers arrange store deliveries.

2.2.4 Residential

- The Bank has yet to participate in exclusively residential developments as the dynamics of the sub-sector are only now making this practicable. The lack of activity in even the Advanced Countries can be attributed to the slow development of factors influencing demand such as effective mortgage markets and relative currency stability. Chart 2.2.4.a. highlights that Poland, the Bank's country of operation with the most advanced mortgage markets, still lags behind other international markets in terms of mortgage debt as a percentage of GDP.

Chart 2.2.4.a.
Aggregate Mortgage Debt as a Percentage of GDP



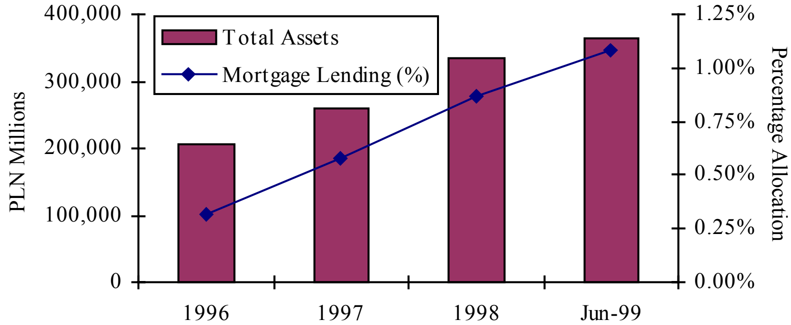
Source: The Urban Institute.

- There are two main reasons for the still ineffective mortgage markets. The first reason, and probably the most important one, is the unavailability of long term refinancing in local currency. This is attributable to insufficiently developed local capital markets and, consequently, to the absence of adequate long term financing instruments such as, for instance, mortgage bonds. Secondly, an immature mortgage market could also be correlated, to a certain extent, to the unwillingness of current lenders to contribute to the development of the market. In effect, current lenders tend to be the main beneficiaries of the existing market inefficiencies and the presently higher than normal returns from lending in this sector.

- The Bank has made an effort to encourage the growth of the Polish mortgage market through its financial institution operations, but in two cases these efforts were ultimately cancelled as market demand could not support the initiatives. The most notable example was the Bank's EURO 269 million partnership with the World Bank and the Polish Government on the Poland Housing Project (BDS92-64), but there was another cancelled attempt with a specific mortgage lender in the PAB Project (BDS95-27).

- Despite its early stage of development, the mortgage market in Poland continues to grow. With certain limitations, property developers in Poland now have the opportunity to finance their projects through commercial banks, thus becoming less dependent on prepayments from purchasers. A positive development in this area is the availability of new insurance instruments which allow banks to bridge the security gap which exists under the present legal framework. Furthermore, an estimated 40% of households can now afford to become homeowners through mortgage finance. Chart 2.2.4.b. displays the aggregate assets of the Polish banking system together with the percentage attributable to mortgage lending since 1996. Mortgage lending currently accounts for about 1% of total banking system assets and experts predict that this figure may ultimately rise to as high as 10%.

Chart 2.2.4.b.
Aggregate Assets in the Polish Banking Sector



Source: Urban Institute.

- Financing for residential developments in the Bank's countries of operations has been derived primarily from shareholder equity and buyer deposits. To the extent that loans have been utilised, it has been limited to the provision of bridge facilities backed by security on the development sites.

- Challenges in residential development are universal across the Bank's countries of operations and therefore the potential for transition impact in this sub-sector is strong. In particular, the effect of residential development on labour mobility can serve to reduce regional economic imbalances over time. Although in the EU accession countries mortgage legislation has been introduced, the banks have still to introduce to the markets a long term mortgage product targeting the majority of the population. In Estonia and Latvia, the early involvement of the Swedish Banks has meant that the mortgage products are already widespread.

- The evolution of this sub-sector will be dependent upon the convergence of several factors. The key obstacle to residential development continues to be an inadequate legal framework, relative currency instability which limits the development of the local money markets and limited institutional base in the Bank's countries of operations. Until such time as mortgage products become widespread, residential development will remain constrained. As the Advanced Countries have been the first to address some of these issues, their success or failure are likely to have implications for the rest of the region. The Bank has an important role to play both through working with local banks on mortgage products and through supporting developers and/or municipalities in establishing appropriate residential development financing structures.

2.2.5 Mixed-Use (including Leisure)

- The implementation of the mixed-use facility concept has followed closely after the large-scale development of stand-alone retail and office facilities. The mixed-use concept is simply to provide consumers with a single location for offices, large-scale retail in the form of a shopping centre with a sizeable anchor, and leisure facilities in the form of a multiplex cinema, bowling, gym or another similar offerings.

- Facilities such as the West End City Centre in Budapest have successfully implemented the mixed-use concept and, as the property markets in the Bank's other countries of operations evolve, there will be interest in similar facilities elsewhere. Such a development tends to work best when done on a large scale and therefore a market must be capable of supporting a significant capacity increase before such developments become feasible.

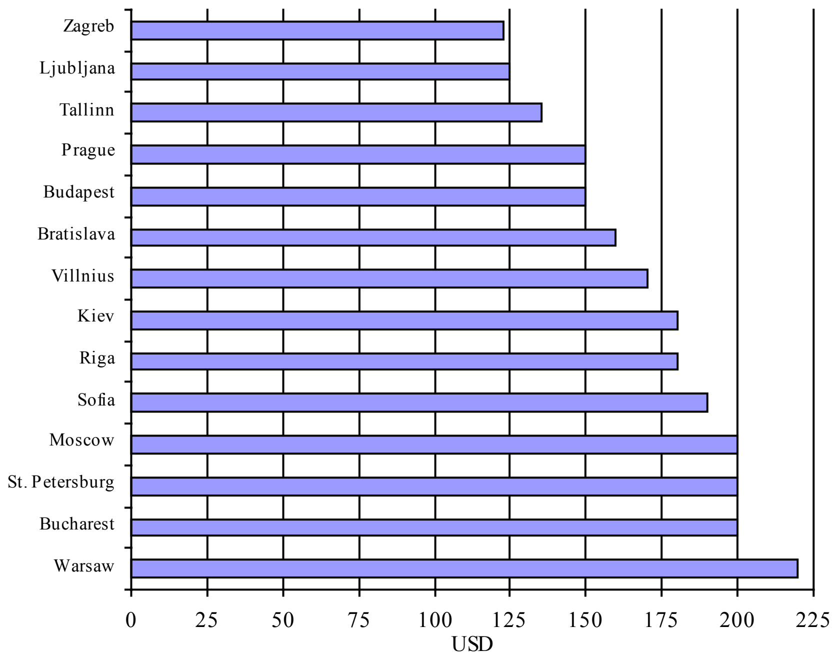
- The Bank's current focus in this sector remains in the Advanced Countries, with projects such as the Polus Centre in Bratislava (BDS99-62) and TriGranit in Budapest with the AIG New Europe Fund (BDS98-63), but opportunities will be evaluated selectively in the Early/Intermediate countries, as well. GDP per capita in the Bank's countries of operations, market demand and the competitive environment will be key determinants of the attractiveness of such projects.

2.3 HOTELS

2.3.1 City Centre Hotels

- City centre hotels, typically of a first class international standard, have been the primary drivers of development in the tourism sector throughout the Bank's countries of operations. International hotel operator interest continues to be present in markets as diverse as Budapest and Bishkek. Chart 2.3.1.a. highlights average room rates in 2000 in 4 and 5-star hotels in selected capitals. In many markets, undercapacity has resulted in inflated room rates.

Chart 2.3.1.a.
Average 2000 Hotel Room Rates



Sources: EBRD, PKF, Healy & Baker, Europroperty Online, Colliers, EIU.

- Budapest, the most mature hotel market in the Bank's countries of operations, has experienced a proliferation of international operator activity. The Bank has been cautious in participating in this development surge largely because of additionality considerations. However, the Bank has played a substantial role in encouraging the development of city centre hotels in other capitals, including those of the Early/Intermediate countries and Russia. Relying on the relatively stable base of business traveller demand, the Bank has financed hotels in Tirana, Bishkek, Riga, Bucharest and St. Petersburg.

- As first class international standard hotel supply increases to the point of maturity in the more advanced markets, it is likely that a second surge of development will occur in the area of international mid-class and budget accommodation. Such developments are often implemented in the form of chains, such as Novotel and Holiday Inn, rather than individual financings.

2.3.2 Regional City Hotels

- Regional city hotels, particularly in the mid-class range, represent an area where the Bank can play the role of catalyst in the future. Opportunities will most likely be limited to single stand-alone developments. The regional centres of Poland such as Szczecin, Gdansk, Krakow, Wroclaw and Lodz are currently the most attractive markets for such developments.

- To date, there has not been a sustained effort by any large mid-market group such as Accor or Bass to establish a fully integrated international standard chain in the Bank's countries of operations. Support for such a programme could theoretically be achieved through the provision of equity and subordinated debt, which could be used to finance a mixed programme of hotels operating under full management or franchise contracts.

- Opportunities in the Advanced Countries, with the exception of Poland, are limited. The restricted number of large regional cities capable of supporting hotel activity is a major constraint. Additionally, there is currently little business travel within the borders of many of the Bank's countries of operation, including in advanced markets such as Hungary and the Czech Republic.

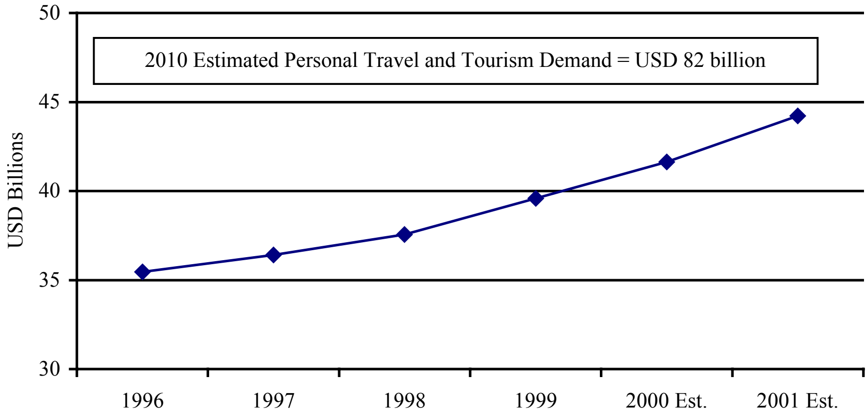
- In the Early/Intermediate Countries, the regional centres of Russia, including Nizhny Novgorod, Ekaterinburg and Samara, and the larger cities of Ukraine offer opportunities in the medium and long term for branded hotel companies. However, the diversity of these markets may create difficulties in establishing and maintaining consistent quality service levels under local management. In these environments, international hotel companies are more likely to insist upon the operation of hotels under full management contracts rather than through franchise agreements.

2.3.3 Resort Hotels/Leisure

- To date, resort hotels and leisure facilities aimed at tourists have not experienced significant development in the Bank's countries of operations. The existing tourist facilities and superstructure in many countries are in need of upgrade and expansion and regional development concepts are largely absent. Compounding the problem is the small size of many tourism projects which makes them difficult to finance directly.

- The potential for tourism to contribute meaningfully to economic prosperity in the Bank's countries of operation is significant. The World Travel and Tourism Council recently estimated that total demand for personal travel and tourism in Central and Eastern Europe will grow to USD 82 billion in 2010 from USD 41 billion in 2000. Chart 2.3.3.a. highlights the recent trend in increasing personal travel and tourism throughout Central and Eastern Europe. However the transactions that the Bank will be involved with will have to be carefully selected and in direct response to market demand not in anticipation of such demand materialising.

Chart 2.3.3.a
Central and Eastern Europe Personal Travel and Tourism

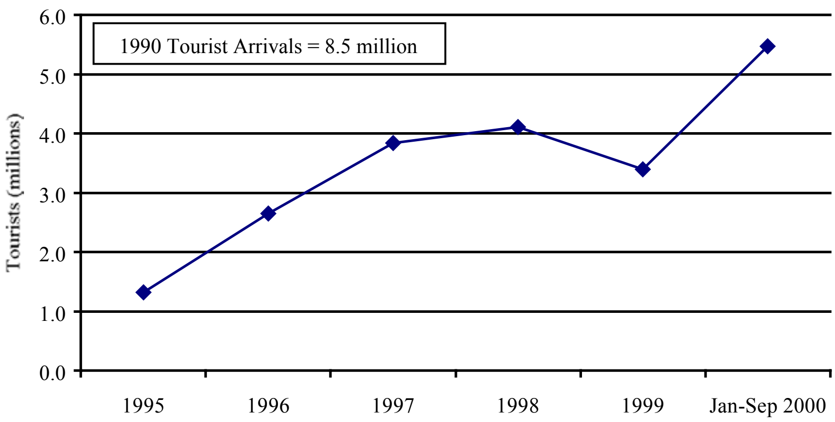


Source: World Travel & Tourism Council.

- Croatia has seen the greatest volatility in leisure tourism over the last 10 years but also represents the most attractive market for investment at this time given its favourable climate, attractive coastline and extensive tourist infrastructure. Historically, tourism has been a powerful driver in the Croatian economy, accounting for between 10% and 12% of total GNP and providing direct employment for 180,000 individuals at its peak in 1989.

- As a result of two conflicts in the region, tourist arrivals to Croatia have yet to reach the levels generated in 1990, but the country is preparing for increasing interest as the region continues to settle politically. Chart 2.3.3.b. highlights the increasing number of international tourist arrivals in Croatia over the last five years. Sequential increases in arrivals were halted by the Kosovo crisis in 1999, but estimates for 2000 suggest a return to the previous trend.

Chart 2.3.3.b
International Tourist Arrivals in Croatia



Sources: World Tourism Organisation, Croatian Ministry of Tourism.

- The Bank has participated in one credit line facility with HBOR for the financing of smaller tourism initiatives in Croatia (BDS96-40) and is actively engaged in the appraisal of a large resort investment that may progress in the short term.

- Leisure tourism presents fundamental transition challenges relating to state ownership and control. In Russia and the Early/Intermediate Countries, direct and indirect state ownership of tourism infrastructure is still prevalent. The primary challenges for the Bank in the tourism sector going forward will be to facilitate the privatisation of tourism infrastructure; to encourage investment in both public and private facilities such as airports, roads and sanitation facilities; and to create international standard accommodation capable of attracting economic activity.

- The constraints surrounding tourism evolution in the Bank's countries of operations are not limited to the industry itself. Municipalities and local governments must share the burden of funding improvements in ancillary infrastructure. Furthermore, unified marketing of tourist regions must be co-ordinated at a government level as tourism companies have limited resources with which to promote regional destinations.

- In meeting the transition challenges in leisure and resort tourism, the Bank must manage the inherent cyclicality of the sector through careful structuring on a case by case basis.

3. BANK'S TRANSITION OBJECTIVES

Recognising the guiding principles of sound banking, transition impact and additionality, the Bank will pursue a number of objectives in the Property sector through careful project selection and transaction structuring. These objectives will require implementation methods and timetables unique to each country of operation. Please refer to Annex C for a matrix of transition impact categories, objectives and responses. The following points represent the core of the Bank's objectives in the Sector:

1. The Bank will support projects that promote private sector investment through equity and debt financing and which create long-term investment vehicles and other new products for local and foreign investors. By doing so, the Bank will promote the growth of both the primary and secondary property markets. The Bank will be additional in mobilising private sector investment through the use of a variety of equity and debt instruments specifically tailored to the property sub-sectors and to the particular transition level of a country. Furthermore, the Bank can have a high transition impact by supporting the creation and growth of investment vehicles and new products which will support further investment in the property markets in the Bank's countries of operation with the aim to bring them, over time, in line with the state of the markets in the rest of Europe. Such vehicles will include sector specific equity funds, pre and post IPO property companies and real estate developers or other capital markets debt or equity instruments such as securitised bonds.

2. The Bank will support smaller projects through participation in Sector-specific investment funds and credit lines aimed at supporting SMEs. Particularly in smaller countries of operations and in regional markets, a selective approach is necessary in order to avoid oversupply or supply of the wrong product. Small

projects can be financed through existing and new investment funds and credit lines in co-operation with local and international investors.

3. The Bank will support projects that transfer technology, knowledge and management skills. Projects in the hotel and logistics sectors will be particularly important in fulfilling this objective. In the Advanced Countries, the continuing lack of international standard warehousing supported by logistics management remains a key constraint on supply-chain efficiency and the transfer of goods. In certain Early/Intermediate Countries with insufficient quality hotel capacity, the Bank's development role in meeting unfulfilled demand will also introduce international standard hotel management and service levels to those local economies. Over time, these management practices will be absorbed into the local hotel industry.

4. The Bank will support projects that develop the local construction and building materials sectors. The Bank can create backward linkages by utilising local suppliers in the construction sector and related industries. In support of good construction practice, the Bank will explore the possibility of applying a portion of its trade facilitation programme to encourage the adoption of standard instruments such as performance bonds by local contractors.

5. The Bank will support environmentally sustainable projects including projects that promote urban regeneration. Such projects may include the reclamation and redevelopment of brownfield sites and the regeneration of disused and underprivileged areas. Where appropriate, the Bank will ensure public consultation with affected parties and municipalities is carried out.

4. INVESTMENT PRIORITIES AND OPERATIONAL APPROACH

4.1 OPERATIONAL PRIORITIES

- In Russia and the Early/Intermediate Countries, the Bank will continue to facilitate the development of quality hotel and office infrastructure in capital cities. The Bank will also endeavour to selectively support projects that promote better logistics and retail infrastructure in response to demand. In the hotel sector, the Bank will selectively support the privatisation of city and resort hotels and promote credit lines for smaller tourism projects as part of its effort to encourage SME investment. The Bank will focus its leisure tourism activities on countries with an established tourism infrastructure. In these markets the Bank will provide mainly senior loans or a combination of debt and equity supported by an agreed exit. In select cases, pure equity may be considered when the risk/return balance can be justified by market circumstances. In these countries the role of policy dialogue will be particularly important due to the inadequate institutional framework to support effective market transition.

- In the Advanced Countries, the Bank will focus on supporting the development of secondary markets by encouraging the growth of established property companies and by creating sector-specific equity funds. The need for equity capital to increase liquidity in the secondary markets is the main driver for the Bank's shift to equity instruments rather than debt in these countries. The Bank will support the introduction of new financial instruments, such as sale and lease back arrangements and will promote sector-specific equity funds capable of investing in completed properties as well as in new developments. However, the ability to create new instruments will be dependent upon local legal and accounting frameworks and the Bank's role in policy dialogue will need to ensure progress on this front also.

- In the Advanced Countries the Bank will focus its efforts in responding to demand for property developments primarily in regional centres rather than capital cities. The main sub-sectors to be developed in such centres are likely to be office, warehousing, retail and two/three star international hotel chains. The Bank's role is most likely to be either that of an equity participant although in certain cases it is likely that the Bank may still play a senior lender role if that is required by co-financing banks. In the case of the latter the maturities and amortisation schedules would be akin to such found in western Europe for similar property developments.

- The Bank will work with co-lenders to accept longer maturities and refinancing risk in hotel and property transactions. In both property and hotel transactions, the Bank will support investments in second tier cities and regional centres with growth potential in order to stimulate economic development and foreign investment, as it is more difficult for such projects to attract commercial bank funding.

- The Bank will increase its focus on residential developments in line with increases in GDP and the introduction and implementation of mortgage laws and broad availability of long term bank mortgages. This is expected to improve labour mobility and overtime lead to a reduction in regional disparities. In this sub-sector the Bank intends to follow a two pronged approach, namely work both with property developers and/or municipalities in financing new residential developments as well as with the local banks by improving their ability to offer competitive residential mortgages to individuals.

- The Bank's direct investments in the Sector will be complemented by other activities that also address the transition challenges. The Bank's work with municipalities can improve their ability to play a responsive role in the market as provider of land, utilities and as a more efficient planning, regulating and taxation authority. In projects that involve urban regeneration the Bank intends to coordinate closely with the municipalities to ensure that their goals and concerns are incorporated in the project design. Further, key infrastructure investments in airports and road links can provide quality of transportation which may be a pre-condition for investments in tourist facilities and warehouses in certain cases.

- The property and hotel markets in the Bank's countries of operations have undergone a sea change in the last decade. The Bank has been able to have a marked effect on the transformation of the sectors and has been highly successful in mobilising a significant size of co-investment. In order to continue its success in the property and, in the future, in the tourism markets also, the Bank will need to continue to adapt, be inventive and creative in terms of new instruments and products that will attract foreign and local investors, while continuing to maintain high standards in terms of credit quality.

4.2 TECHNICAL CO-OPERATION

- Technical Co-operation has not been used thus far in the Property sector at the Bank. Property projects tend not to require official co-financing support as the developers experienced enough to complete a project tend to have access to the necessary funding. The Bank has used Technical Co-operation funding in the Tourism sector, however, where there is a greater need from local sponsors for supplemental funding at the outset of projects. As highlighted in Table 4.2.a., the Bank has used such funding to finance three regional tourism studies and two project-specific market and strategy studies to assist in the appraisal of an investment programme for Plava Laguna, a Croatian tourism company.

Table 4.2.a. Technical Co-operation Commitments at 30 June 2000 (EURO millions)		
Projects	**Signed**	**TC Funds**
Crimea Tourism and Hotel Study	30 Nov 95	0.05
Albanian Southern Coast Tourism Study	31 Dec 96	0.70
Bulgarian Tourism Study	05 Sep 98	0.07
Plava Laguna Strategic Review	23 Nov 99	0.09
Plava Laguna Market Study	09 Dec 99	0.08
Total TC Projects		0.99

4.3 CO-FINANCING SOURCES

- The Bank has mobilised co-financing for 14 Property projects. Government institutions, commercial banks and Export Credit Agencies have all contributed to Bank projects in the Sector. Participating government institutions have included JAIDO (Japan), COFACE (France), FEC (Finland), EKN (Sweden) and OPIC (USA). The objective in mobilising these sources of finance was to enhance borrower creditworthiness and manage the Bank's exposure. Please refer to Annex D for a comprehensive summary of the Bank's co-financing activities.

- Co-financing with commercial banks was primarily accomplished on a participation basis with an A/B loan structure. Central European projects in the sector tended to draw finance from Austrian banks, while projects in other countries involved German, French, Italian and Belgian institutions.

- The Bank will continue to utilise co-financing sources in the Sector. Co-financing objectives will include the expansion of the existing co-financier base the encouragement of longer loan maturities. The Bank will particularly support the use of the following three co-financing structures in the Sector:

  - Commercial bank participation in A/B loan structures
  - Export Credit Agency participation without state guarantees, using EBRD involvement to alleviate the concerns of ECA's
  - Co-investment with international private equity investors and institutional investors.

4.4 PROJECTED LEVEL AND COMPOSITION OF EBRD FINANCING

- Annual signings are projected to rise from a level of approximately EURO 100 million in 2000 to potentially EURO 175 million in 2005. The achievement of this growth would be dependent on appropriate resources being allocated by the Bank to the Sector as the increased level of commitments materialises. The Bank's portfolio in the Sector as at December 31st 2000 stood at 53% debt and 47% equity. Of this, the majority of the equity was in the Advanced Countries. The target for the Bank in the Sector is an even split between debt and equity in the medium term. In the short term this target may be overrun due to the transition needs in the Advanced Countries, refinancings of early debt transactions and the fact equity type instruments are the ones most likely to maximise the Bank's transition impact and additionality in these countries.

- The Bank's portfolio in the Sector as at December 31st, 2000 was distributed as follows: 54% Advanced Countries, 25% Early/Intermediate, 9% Russia and 12% Regional. In the medium term the Bank's goal is to achieve a balance of 45% Advanced, 30% in Early/Intermediate, Russia 10% and Regional 15%. The current weighting in Advanced Countries has been the result of concerted marketing over the last 2 years to rebalance the portfolio in the Advanced Countries which stood at 44% at the end of 1998 as well as from an increase in demand from international developers and financial investors to step into these countries alongside EBRD partially as a result of the Russian crisis. The current country portfolio balance is likely to be maintained over the next two years due to the strong pipeline the Bank has developed. In parallel, the pipeline is growing in Early/Intermediate and Russia.

- In terms of portfolio composition by sub sector as at December 31st 2000, offices stood at 18%, mixed use at 42%, hotels at 26% and warehousing at 14%. This compares to a medium term target of mixed use 40%, hotels and leisure 30%, offices 15%, warehousing 10%; residential 5%.

4.5 PROCUREMENT

- All of the Bank's projects in the Sector to date are classified as being private sector for procurement purposes. Competitive selection procedures, managed by the project companies or their advisors, are followed for all works. The Bank typically appoints an independent construction expert as its lender's supervisor in order to ensure that costs are in line with market prices and that procurement and implementation are satisfactory to the Bank.

- In addition to monitoring construction progress, the lender's supervisor is responsible for reviewing and monitoring contracts throughout the construction period to verify that costs are in line with current market prices and that contract conditions are fair and reasonable. Project companies are responsible for providing contract award data such as the name and nationality of tendering companies, the contract award date, the description of services provided and the estimated completion date. The lender's supervisor additionally monitors and approves all sums paid during the construction period.

- The Bank expects its focus to remain on private sector projects in the Sector and therefore it will continue to follow its current methodology in managing procurement issues.

4.6 ENVIRONMENT

The Bank financing in the property sector is designed, where appropriate, to promote environmentally sustainable development projects and urban regeneration, including the reclamation and redevelopment of brownfield sites and disused and underprivileged areas. Where operations are located in sensitive locations and Environmental Impact Assessments (EIA) are required, the Bank's public consultation requirements for "A" level projects will apply.

The environmental due diligence process for the property sector is designed to ensure that all of the Bank's projects include appropriate safeguards to protect the environment and the wellbeing of the public both during the development and operational phases. The following key issues have formed part of the Bank's standard requirements for all signed projects in the Sector:

- Construction and development is undertaken in accordance with national and EU environmental, health and safety legal requirements and standards.
- Prior to construction, all applicable planning, building and land use environmental permits are received from the relevant authorities.
- Appropriate public consultation is conducted in accordance with national requirements and the Bank's Public Information Policy.
- The development complies with all local fire, safety and emergency procedures.
- Energy, water and materials conservation measures are incorporated in the projects along with the provision of clean air filtration systems.
- Appropriate measures are taken to ensure minimal noise disturbance to surrounding houses and other land uses during construction and operation.
- Environmentally damaging materials or substances (ozone depleting substances, asbestos, formaldehyde, oil-cooled transformers etc.) are not used in the construction.
- Adoption of international industry practice, corporate policies and procedures by Sponsors to ensure high standards of environmental, health and safety and reduce environmental impacts during construction and operation.

On the tourism side, whilst the Bank's involvement to date has been focussed on city centre hotels, it is recognised that future development of tourism facilities in sensitive locations may pose special challenges. These include issues such as infrastructure support (water supply, sewage treatment, and access routes), cultural and heritage sites, local community issues and wildlife habitat management. EBRD will seek to develop all of its tourism operations in accordance with the principles set out in the programme of actions adopted by the United Nations Conference on Environment and Development (UNCED) for the Travel and Tourism Industry (Agenda 21), and in line with World Bank Guidelines on Tourism and Hospitality Development.

ANNEXES

ANNEX A PROPERTY SUB-SECTORS

- Building, Developing and Land
- Property
  - Office space for private businesses
  - Shop space for retail trade
  - Warehousing and industrial facilities for storage and distribution
  - Residential development
  - Mixed-use facilities (combinations of office, retail and leisure facilities)
- Hotels
  - City centre hotels
  - Regional city hotels
  - Resort hotels and leisure
- Parking Lots and Garages
- Food Services and Drinking

ANNEX B OVERVIEW OF BANK SIGNED PROJECTS AS AT 31 DECEMBER 2000

(includes cancellations and completed projects)

P&T Signed Projects by Project Type (EURO millions)			
Project Type	**No. of Projects**	**Total Cost**	**EBRD Finance**
Offices	10	349.4	82.1
Mixed-Use	5	497.3	121.2
Warehousing	4	128.5	60.2
Hotels	10	378.8	117.1
Tourism	1	30.7	30.7
Investment Funds	2	151.7	38.9
Total Projects	32	1,536.3	450.1

P&T Signed Projects at 31 December 2000 by Transition Stage (EURO millions)			
Transition Stage	**No. of Projects**	**Total Cost**	**EBRD Finance**
Advanced	16	849.1	237.1
Early/Intermediate	9	286.8	94.5
Russia	4	129.1	64.3
Regional	3	271.1	54.1
Total Projects	32	1,536.3	450.1

P&T Signed Projects at 31 December 2000 by Product Type (EURO millions)			
Product Type	**No.**	**EBRD Finance**	**%**
Senior Loans	25	257.9	57.0
Mezzanine Products	6	29.3	7.0
Equity Investments	12	162.9	36.0
Total Projects	42	450.1	100.0
Note: The total number of projects is greater than the Bank's total of Property sector projects as some projects include the provision of a combination of senior loans, mezzanine products and equity investments.			

Projects Signed	Country	Classification	Total Cost	EBRD Finance (EURO 000)
Offices				
St Petersburg Property Development	Russia	Private	7,038	3,376
Nevsky Prospekt 25 Loan	Russia	Private	32,636	9,352
Turan Alem Towers	Kazakhstan	Private	30,088	10,531
Waresco Sp.z.o.o.	Poland	Private	36,632	10,054
Warsaw Financial Centre	Poland	Private	125,850	20,524
Valdemara Centrs SIA	Latvia	Private	21,055	7,167
Waresco – Extension of Facility	Poland	Private	4,760	1,397
Central Business Centre	Hungary	Private	18,407	5,853
Atrium Business Centre	Poland	Private	38,416	5,642
Victoria Office Building	Romania	Private	34,494	8,167
Total Offices			**349,376**	**82,063**
Mixed-Use				
European Property Group	Czech Rep.	Private	152,324	36,111
Alpha Properties	Poland	Private	91,179	12,220
Polus Centre	Slovakia	Private	72,900	27,000
Trigranit	Regional	Private	94,885	13,605
Globe Trade Centre	Poland	Private	85,966	32,237
Total Mixed-Use			**497,254**	**121,173**
Warehousing				
Italian-Romanian Industrial Dev. Enterprise	Romania	Private	33,320	10,550
Faure & Machet	Poland	Private	22,792	7,883
FM Russia	Russia	Private	58,349	36,103
Warsaw Distribution Centre	Poland	Private	14,034	5,642
Total Warehousing			**128,495**	**60,178**
Hotels				
Continental Hotels	Regional	Private	35,364	12,358
Nevsky 49 (Radisson SAS St Petersburg)	Russia	Private	31,120	15,581
Radisson SAS Kyiv	Ukraine	Private	39,497	13,575
Athenee Palace Hilton	Romania	Private	65,835	15,345
Hotel Rogner	Albania	Private	29,568	10,229
Tirana Hotel	Albania	Private	18,367	10,867
Daugava Riga Radisson Hotel	Latvia	Private	45,992	12,895
Hyatt Bishkek	Kyrgyzstan	Private	25,253	8,597
Silk Road Motel	Azerbaijan	Private	5,300	1,690
Atrium Hotel Warsaw	Poland	Private	82,500	16,020
Total Hotels			**378,796**	**117,156**
Tourism				
Tourism Credit Line (HBOR 1)	Croatia	Public	25,565	25,746
Bulgaria SME & Tourism Credit Line	Bulgaria	Private	5,100	5,100
Total Tourism			**30,665**	**30,665**
Investment Funds				
Pioneer Polish Real Estate Fund	Poland	Private	10,693	10,693
Heitman Central Europe Property Partners Fund	Regional	Private	141,037	28,207
Total Investment Funds			**151,730**	**38,900**
Grand Total			**1,536,316**	**450,136**

ANNEX C **TRANSITION IMPACT IN THE SECTOR**

Transition Impact	Bank's Objectives	Bank's Response
1. More intense competition in the project sector • Number of foreign and local investors. • Provision of goods and services previously unavailable or previously available at lower quality standards.	• Reduction in inflated property sector rents for offices, retail and warehousing. • Reduction in inflated hotel room rates in markets with little competition. • Improvements in quality standards in the office, retail, warehousing and hotel sectors.	*Early stages* • Mobilise private sector investment through the use of a variety of debt instruments in order to promote competition in local markets. • Facilitate participation of international investors through co-financing opportunities with the aim of encouraging active investment in the region. • Support the involvement of reputable international managers and operators for properties and hotels. *Advanced stages* • Encourage investment development through the use of a variety of equity instruments specifically tailored to transition level. • Contribute to the development of secondary markets through sector funds, encouraging the entrance of institutional equity and creating an environment with greater exit opportunity for developers.

Transition Impact	Bank's Objectives	Bank's Response
2. Market expansion in other sectors • Secondary markets for property • New investment products • Residential development • Investment in SMEs	• Aid in the creation of efficient secondary markets with sufficient depth for the purchase and sale of existing properties. • Innovate by introducing new products for local and foreign investors. • Provide the market with a model financing in the residential sector. • Provide support for SMEs through equity funds and tourism credit lines.	*Early stages* • Finance credit lines and facilitate co-operation with local and international investors. *Advanced stages* • Stimulate secondary market liquidity through the creation of long-term institutional investment vehicles. • Introduce new property investment products and methods to the Advanced Countries to promote convergence with international practice. • Encourage residential development through equity investment in development or residential construction entities with sufficient critical mass.

Transition Impact	Bank's Objectives	Bank's Response
3. Private ownership, competition and backward linkages • Tourism property ownership • Construction and building materials sector	• Maximise private sector involvement in tourism investment and promote privatisation of state tourism assets. • Create backward linkages in the construction and materials sectors by utilising local subcontractors and suppliers.	*Early stages* • Continue policy dialogue and potentially participate in further privatisation of state property assets. • Encourage the use of local contractors and suppliers working under the umbrella of turnkey contractors or international project managers. *Advanced stages* • Strongly support the revival of the tourism industry in Croatia through direct project investment to create a positive demonstration effect for the entire region. • Promote investment in the real estate sector by local institutional investors such as pension funds and insurers to provide "local liquidity" in the market and increase private ownership. • Consider the use of sufficiently capitalised local contractors in the Advanced Countries for refurbishment and development projects.

Transition Impact	Bank's Objectives	Bank's Response
4. Frameworks for markets • Real estate valuation methods • Simplification of regulatory frameworks for real estate	• Support effective and transparent valuation methods for real estate assets, particularly in the tourism industry where values have decreased. • On a project by project basis, challenge existing real estate regulatory frameworks to encourage convergence with international norms.	*Early stages* • Continue policy dialogue to promote regulatory reforms in the short, medium and long term. *Advanced stages* • On individual financings, work with local authorities to simplify registration procedures for real estate assets and seek commitments to the simplification of lease rights.
5. Transfer of technology, knowledge and skills • Upgrade technical and managerial skills	• Maximise the impact of the transfer of technology and knowledge throughout the Sector, particularly in hotels and logistics.	*Early stages* • Continue to introduce international standard hotel management and service levels to local economies *Advanced stages* • Introduce international standard warehousing supported by logistics management as a necessary condition for achieving supply-chain efficiency.

Transition Impact	Bank's Objectives	Bank's Response
6. Demonstration effects • Innovative financing structures • Convergence with international property markets • Development of secondary markets	• Create replicable practices that create transition impact at a project level.	*Early stages* • Continue to seek co-financing opportunities with local and international investors. *Advanced stages* • Introduce pre- and post-IPO property companies and real estate developers. • Invest in and support sector-specific equity funds. • Introduce innovative instruments such as capital market debt or securitised bonds.
7. Enhancing standards for corporate governance and business conduct • Protection of minority shareholders • Improvement of business conduct rules	• Foster improvement in corporate governance arrangements at the enterprise level	*Early stages* • Continue to require the adoption of commercial methods in accounting and management techniques. *Advanced stages* • Establish effective incentive and monitoring systems to improve performance.

ANNEX D CO-FINANCING SUMMARY TO DATE AT 31 DECEMBER 2000

Projects Signed	Project Country	Co-Financier	ECA	Country of Origin	Finance Type
Offices					
Atrium Business Centre	Poland	Citibank, N.A. Mees Pierson Polish Devel. Bank Swedish Export Credit	 EKN	USA Netherlands Poland Sweden	Participation Participation Participation Gov. G’tee
Central Business Centre	Hungary	Raiffeisen Zentralbank JAIDO		 Austria Japan	 Participation N/A
St Petersburg Property Development	Russia	OPIC	OPIC	USA	Loan
Valdemara	Latvia	Swedish Export Credit	EKN	Sweden	Parallel Loan
Waresco	Poland	Generale Bank		Belgium	Participation
Warsaw Financial Centre	Poland	Bank Austria Creditanstalt Bayerische Landesbank Girozentrale Berliner Bank AG Hypo Vereinsbank Raiffeisen Zentralbank Citibank, N.A.		Austria Germany Germany Germany Austria U.S.A.	Participation Participation Participation Participation Participation Participation Parallel Loan
Mixed-Use					
Polus Centre	Slovakia	Raiffeisen Zentralbank Raiffeisen Affiliates		Austria Austria	Participation
Warehousing					
Faure & Machet	Poland	Polish Development Bank		Poland	Parallel Loan
FM Russia	Russia	Banque Commerciale pour L'Europe Credit Lyonnais Raiffeisen Zentralbank		France France Austria	Participation Participation Participation
Italian-Romanian Industrial Development Enterprise	Romania	BPD Property Development Finest Spa RPPF RZB		Italy Italy Romania Austria	Equity Equity Equity Participation
Warsaw Distribution Centre	Poland	Raiffeisen Zentralbank JAIDO		Austria Japan	Credit Line N/A
Hotels					
Athenee Palace Hilton	Romania	Societe Generale	COFACE	France	ECA G’tee
Continental Hotels	Romania	RPPF		Romania	Equity
Daugava Riga Radisson Hotel	Latvia	Finnish Export Credit		Finland	ECA Gtee
Atrium Hotel Warsaw	Poland	CDC-IXIS		France	Senior Loan